EXHIBIT 5
Landlord-Funded Improvements: Who Owns the Asset?

In many situations, the language in the lease contract is unclear concerning the "owner" of the landlord-funded improvements. In May 2005, the EITF Agenda Committee discussed certain ramifications of this unresolved ownership issue and put forth a possible solution. The committee identified 13 qualitative factors that might be considered by the lessor and lessee in determining which party owns the leasehold improvements and therefore should recognize them for financial statement purposes. These factors included examining the obligations of the parties, remedies in the event of default, the tenant's responsibility if the improvements are altered or removed, the uniqueness of the improvements, the party liable for property taxes, and other legal and economic issues. Due to the complexities and subjectivity involved, the EITF Agenda Committee decided not to tackle this ownership issue.

The lack of formal guidance and the divergence in accounting practice has associated implications on financial reporting by lessors and lessees. Two of these are as follows:

Financial statement recognition and classification. If the improvements funded by the lessor are deemed to be owned and recognized as assets by the lessee, the lessee would also recognize the associated amortization expense and annual reductions in rent expense on its income statement using the methodology illustrated in Exhibit 3. The lessee's statement of cash flows would reflect the acquisition of the leasehold improvements in investing activities and the incentive received in operating activities. On the lessor's balance sheet, the payments should be recognized as an incentive and amortized as a reduction in annual rental income over the lease term. The incentive paid would be reported in operating activities on the lessor's statement of cash flows.

If, however, based on an evaluation of the facts and circumstances, the landlord-funded improvements are deemed to be owned by the lessor, the lessee would treat the cash received from the lessor as a reimbursement of costs on its balance sheet—not as an incentive. Accordingly, the underlying leasehold improvements, the liability for the incentive, the related annual amortization expense, and the reduction in rent expense would not be reported on the lessee's financial statements. The associated cash transactions would be reported by the lessee in operating activities on the statement of cash flows. The lessor would record and depreciate the tangible assets over their estimated useful lives and report the expenditures in investing activities on the statement of cash flows.

Lease commencement date: Does the lessee "control" the improvements? Another implication of this unresolved ownership issue pertains to whether the lessee should recognize rent expense during the construction period. As discussed previously, the recognition of rent expense begins at the point in which the lessee obtains possession of or controls the property. If the lessee owns the landlord-funded leasehold improvements, the case for control is established. Accordingly, straight-line recognition of rent expense by the lessee and rental revenue by the lessor should begin when the lessee has access to the leased property to begin constructing the improvements. If the lessor is deemed to be the owner, however, and the improvements are considered property subject to the lease, the presumption of control by the lessee during construction is not clearly established. Accordingly, recognition of rent expense by the lessee and rental income by the lessor should begin when the improvements are substantially complete.